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Finance Fragmented? Frankfurt and Paris as European financial centres after Brexit

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Abstract

Brexit creates an opportunity for alternative European financial centres. However, no comprehensive empirical analysis of the strategic positioning of actors within these financial centres has been conducted. In this article we outline findings from an extensive research project which we conducted in Frankfurt and Paris, two of the main ‘rivals’ to the City of London, in the aftermath of Brexit. We outline the core findings from this project and argue that the emerging competition between Frankfurt and Paris is shaped through four related axes: diversity, path dependency, territory and regulatory stability. Our analysis has implications for two bodies of literature within EU studies. First, inter-governmentalist and supra-nationalist approaches would benefit from interrogating more closely the contested sub-national politics of financial centres. Second, our analysis adds to a growing body of literature on European disintegration by interrogating the interaction of fragmentary and integrative dynamics in the sphere of European finance.

Key words

Financial centres, Brexit, Finance, Disintegration, Paris, Frankfurt

Introduction

Brexit is likely to result in financial firms domiciled in the UK losing their passporting rights. As a result, significant business functions are likely to leave the City of London and relocate to inside the Eurozone. This has created the conditions for a ‘battle’ between European member states and financial centres in the aftermath of the Brexit vote (Howarth and Quaglia 2018). Despite these shifts, no comprehensive analysis of the strategic positioning of actors *within* alternative European financial centres has been conducted. This empirical deficit is compounded by a deeper theoretical challenge. Integration theorists have tended to analyse the evolution of European finance from either a supra-national or inter-governmental perspective. As a result, financial centres have been neglected analytically in the EU studies literature. Furthermore, this literature tends to assume that integration takes place against a background of growing economic interdependence which limits its capacity to account for emerging patterns of *disintegration* within the EU (Vollaard, 2014; Zielonka, 2014).

This article seeks to overcome these blind spots by asking how actors within European financial centres have responded to the Brexit vote. The article draws on an extensive research project which we conducted in Frankfurt and Paris, the two leading ‘rivals’ to the City of London after Brexit, between November 2017 and March 2018. From our case studies, we highlight four key observations, which together emphasise the importance of *diversity*, *path dependency*, *territory* and *regulatory stability* in shaping the emerging competition between financial centres after Brexit.

Our empirical analysis has important theoretical implications for the EU studies literature. First, we argue that conventional supra-nationalist and inter-governmentalist approaches within EU studies cannot capture the peculiar character of financial centres, which embody distinctive spaces within which local, national and global forces interact. In order to better account for the emerging competition between European financial centres after Brexit, we argue that theorists

of European integration should draw upon a rich vein of scholarship within economic geography which has interrogated relations between global financial centres. Second, we argue that a focus on financial centres can shed new light on emerging processes of European *disintegration*. Brexit is likely to generate a geographical *fragmentation* of European financial markets. But it also creates new pressures for integration and supervisory convergence. A financial centres perspective can illuminate how this dynamic process of fragmentation and integration is shaped by actors operating at the sub-national level.

The article proceeds as follows. In the first section, we argue that conventional approaches in EU studies have neglected financial centres which in turn limits their ability to analyse the emerging competition between European financial centres after Brexit. In the second section, we introduce our two empirical case studies - Frankfurt and Paris after the vote for Brexit - and outline the methodology which underpins our research. In the third section, we outline four key observations which together highlight the importance of *diversity*, *path dependency*, *territory* and *regulatory stability* in shaping the emerging competition between European financial centres. In the fourth section, we argue that our empirical analysis has broader theoretical implications for the EU studies literature. The final section concludes.

Theorising European financial centres in a context of fragmentation

The EU studies literature is limited in its capacity to explain the emerging competition between European financial centres after Brexit. As Quaglia and Howarth (2018) have noted, the EU studies literature deploys two broad lenses through which to understand the future of European finance. The first is *supra-nationalist* in orientation (Farrell & Newman, 2015; Mügge, 2010; Van Apeldoorn, 2002). Supra-nationalist approaches analyse how transnational actors, such as global firms and European financial lobby groups, organise at the European level and mobilise

to shape EU financial policy and regulations in line with their own interests. This scholarship has been complemented by work which looks at how powerful EU institutions, for example the European Central Bank (ECB), seek to secure their policy goals, such as macroeconomic stability, by extending and thereby ‘governing’ through financial markets (Braun, 2018; Braun and Hubner, 2016). From this first perspective, we should see the formation of transnational coalitions in the aftermath of Brexit which seek to minimise the disruptive impact on business interests (Quaglia and Howarth, 2018).

A second perspective, derivative of *inter-governmental* approaches, focuses on the ways in which the preferences of member states are shaped by national ‘varieties’ of financial capitalism (Deeg, 2010). For example, inter-governmentalists explain divergent member state preferences on Capital Markets Union and Banking Union by pointing to whether national financial systems display a ‘bank-based’ or ‘market-based’ structure (Quaglia et al., 2016). This perspective - which is ultimately the one that is adopted by Quaglia and Howarth (2018) - expects to see a ‘neo-mercantilist’ race emerging between member states after Brexit as they compete to induce financial activity into their own territories.

Whilst these approaches capture important aspects of the ‘battle’ over European finance after Brexit, there is a risk that they omit important aspects of the emerging competition between European financial centres. Supra-national approaches render financial centres invisible by privileging analytically the transnational policy-making process. Inter-governmental approaches view financial centres as derivative of particular national ‘varieties of capitalism’. Neither of these approaches can adequately capture the peculiar character of financial centres, which embody distinctive *sub-national* sites where global, national and local dynamics interact in complex ways.

Financial centres embody crucial ‘nodes’ in transnational networks of global finance, through which global capital flows travel and come to be organised (Wójcik, 2013; Hall 2017). They host a variety of financial actors - from global banks to domestically oriented creditor institutions - as well as ancillary service providers, regulators and political actors (Sassen 2011). This gives financial centres a distinct character. They are ‘internationalised’ entities that are nonetheless embedded in distinct local and national contexts (Macartney, 2010). This means that financial centres are *sui generis* sites within European capitalism. As such, financial centres should be studied empirically in their own right, as distinctive spaces with their own peculiar dynamics and characteristics. Our empirical material on Frankfurt and Paris builds upon this insight and advances a new lens for theorising the ‘battle’ for European finance after Brexit.

There is a second lacuna in the EU studies literature which limits its ability to explain emerging patterns of competition between European financial centres. As Rosamond (2016: 865-6) argues, both inter-governmentalist and supra-nationalist approaches assume that integration occurs against a series of ‘prior background conditions’ (ibid). In particular, growing ‘economic interdependence’ and increasing ‘transnational exchange’ are viewed as underlying drivers of regulatory convergence at the EU level (Moravcsik, 1993; Sweet and Sandholtz, 1997).

Brexit is likely to fundamentally disrupt this logic (Lavery et al., 2018). It embodies a moment of potential ‘regulatory decoupling’ between the UK and the EU which in turn will produce new barriers to trade between the two blocsⁱ. This is particularly the case in the sphere of finance. Brexit is likely to generate a dynamic of financial market *fragmentation* for three principal reasons. First, it is likely to generate new barriers to entry for UK banks and financial institutions seeking access to the Single Market. Second, and relatedly, this means that there are political pressures to re-locate business activities to within the Single Market. This is likely to generate a geographical dispersal of financial activities between rival European financial centres. Third, it creates new regulatory challenges, particularly in relation to the supervision of

financial activities. The dispersion of financial activities throughout different EU member states distributes supervisory responsibility between different national competent authorities (NCAs), creating the threat of supervisory divergence and regulatory arbitrage.

The potential financial market fragmentation unleashed by Brexit is likely to impose costs on numerous actors. For example, the dispersal of business activities will force firms to duplicate resources and is likely to lead to increased transaction costs. However, some actors are well-placed to benefit from this process of fragmentation. Our case studies of Frankfurt and Paris examine how some actors within European financial centres have positioned themselves in order to ‘capitalise’ on the Brexit process.

Methodology

Frankfurt and Paris were selected as case studies of alternative European financial centres after Brexit for a number of reasons.ⁱⁱ Historically, both Frankfurt and Paris have been located in the ‘second tier’ of IFCs after the dominant global triad of New York, London and Tokyo (Cassis, 2006) and both are currently both ranked as ‘Global Leaders’ with ‘broad and deep’ financial centre portfolios by The Global Financial Centres Index (Z/Yen and CDI 2018: 13). In the decade since the financial crisis, Frankfurt and Paris have retained their position amongst the world’s top eight financial centres, placing them as European financial hubs second only to the City (Cassis, 2018: 1). Frankfurt has been ranked as the EU’s second most competitive financial centre whilst its financial and related services sector employs 130,000 workers (Schamp, 2018). Paris plays host to the largest financial workforce in the eurozone (330,000) and “offers the second largest asset management in the world with \$1,693 billion in assets” (Lavery et al., 2017; Quennouëlle-Core, 2018: 73; Paris Europlace 2018). Furthermore, both Frankfurt and Paris are embedded within the EU’s two most powerful member states. Each city also plays host to key EU regulatory and supervisory authorities – such as the ECB and the European Insurance

and Occupational Authority (EIOPA) in Frankfurt and the European Securities and Markets Authority (ESMA) and European Banking Authority (EBA) in Paris.

The data on which this article draws comes predominantly from 29 semi-structured elite interviews conducted with stakeholders in both Frankfurt (November 2017) and Paris (February and March 2018). We ‘mapped’, contacted and interviewed a diverse set of political and economic actors in both cases in order to facilitate a disaggregated understanding of the various actors’ interests and attitudes within each financial centre. Across both cases, we spoke with actors at five global and regional banks, four financial marketing/lobbying organisations, two national regulatory authorities, three financial market infrastructure providers, three trade associations, three national and local level government agencies and an EU agency. This interview data is supported by documentary analysis of over 300 French and German language strategy documents, marketing statements, policy reports, public statements and interviews from political and economic actors in both Paris and Frankfurt, which were translated, coded and analysed during an earlier phase of this research project.

Frankfurt and Paris as financial centres after Brexit

In the following subsections, we answer the core research puzzle of this article: how have actors within European financial centres responded to Brexit? Outlining our key findings from Frankfurt and Paris, the analysis emphasises the importance of conceptualising the emerging competition between European financial centres in terms of *diversity*, *path dependency*, *territory* and *regulatory stability*. These four observations are related insofar as together they underline the importance of analysing empirically financial centres as distinctive sub-national sites of economic organisation and political power. Each empirical observation in turn has broader theoretical implications for the European studies literature, as outlined in the penultimate section of this article.

1. The financial centres of Frankfurt and Paris centres contain numerous actors with divergent strategic orientations

Financial centres are not homogenous entities. They contain numerous actors with often divergent interests and strategic priorities. In broad terms, the first distinction that can be drawn is between ‘political’ and ‘economic’ actors. This is an important distinction, because as a representative of a global bank in Frankfurt noted with regards to the opportunities created by Brexit for alternative financial centres:

‘It depends on who you ask. If you are asking local policymakers in some of the cities that now may benefit from an influx of investment bankers and so on, they will probably say that Brexit is a good deal for us. For the financial industry, it is definitely a ‘lose-lose’ situation. There is no gain in an increase in fragmentation. There will be additional costs.’ (Global bank A official in Frankfurt, 07/11/2017)

As this quote suggests, political actors are embedded within a particular territorial context and respond to a distinct set of incentives. Their main concern is to boost business activities, employment and tax revenues in their respective territories. As a result, they tend to adopt a proactive role in promoting their respective financial centres after Brexit. ‘Economic’ actors, on the other hand, act according to a different incentive structure. Broadly speaking - and allowing for differences in their approach to the territory, as discussed below - economic actors tend to be less concerned with boosting a specific financial location. For them, the primary concern is to contain instability and minimise transaction costs. Actors within Frankfurt and Paris therefore display contending strategic priorities in relation to key post-Brexit issues, for example in

relation to euro-denominated clearing, as we discuss subsequently. This implies that it is necessary to disaggregate and ‘map’ the different actors that operate within Frankfurt and Paris as financial centres.

In the case of Frankfurt, the state of Hesse and the Frankfurt city government have played a key role in promoting the German city as a financial centre. These bodies have been directly involved in coordinating promotional activities and have contributed funds towards a variety of lobbying groups and marketing agencies with the express goal of furthering Frankfurt as a financial centre, including the Frankfurt Main Finance and Frankfurt Rhein Main lobbying groups. A number of initiatives have been coordinated by this political network, such as roadshows, media outreach campaigns, international meetings as well as lobbying efforts.

In the case of Paris, political actors at the national level, including both the Socialist administration under President Hollande and Emmanuel Macron’s new centrist administration, have assumed a more prominent role in promoting Paris as a financial centre after Brexit. These national-level interventions are flanked by complementary regional initiatives. The council of the Île-de-France region has been active in both a PR campaign to improve the image of Paris as a city open to finance and business and the facilitation of initiatives such as ‘Choose Paris Region’, a ‘one-stop shop for simplifying procedures for foreign investors’. The efforts of both national and local actors have been complemented by Paris EUROPLACE, a financial lobby organisation with strong personal links to both the private sector firms and government, including a ‘very good relationship’ with the French Treasury (French Treasury official (A), 27/02/2018).

Frankfurt and Paris also play host to a broad range of market actors with distinct business models and investment strategies. Four broad types of financial institutions within both financial centres can be identified. The first is made up of *transnational* financial institutions - and in particular global banks - that have a presence in Frankfurt and Paris. Examples of these include

Deutsche Bank in the case of Frankfurt and HSBC and Société Générale in Paris. The second type includes *market infrastructure providers* - in particular stock exchanges and associated clearing houses - such as Deutsche Börse and Euronext Paris. The third type is made up of regionally-oriented financial institutions, such as the Landesbank Helaba. Lastly, there are *trade associations* which represent sub-sectors from within finance - for example large banks or asset management companies - who seek to engage with both regulators and state officials.

2. Path dependencies and comparative differences shape the emerging competition between Frankfurt and Paris

Within the public debate as well as in the academic literature, the ‘race’ between European financial centres is often conceptualised as having begun in June 2016, in the aftermath of the ‘Brexit’ vote (see Shotter et al. 2017; Howarth and Quaglia 2018). Furthermore, this ‘battle’ is often implicitly assumed to involve units - the various financial centres - which are comparable in terms of their functional capacities and political composition. But the ‘battle’ over European finance takes place upon an uneven institutional terrain and involves financial centres with distinct characteristics. *Path dependencies* play an important role in shaping the emerging competition between European financial centres after Brexit.

Financial centres have long pre-histories which shapes their contemporary structure in important ways (Cassis, 2006). Some European financial centres have specialisations in specific sub-sectors such as investment banking or asset management. Global banks also have pre-existing linkages with European financial centres, for example through having branches or back office functions in different locations. Furthermore, relations between financial centres and political structures differ markedly across different states. Collectively, these varying institutional

arrangements condition the terrain on which the emerging ‘battle’ between European financial centres is taking place.

Our empirical material from Frankfurt and Paris underscores the key importance which path dependencies play in shaping emerging patterns of competition between these centres. As one representative of a global bank in Frankfurt noted, ‘traditional linkages of individual institutions to different markets are key. HSBC has a long standing and large presence in France whilst German and many Swiss banks have Frankfurt as their traditional hub. Many US investment banks have a link towards Dublin’ (Global bank A official in Frankfurt, 07/11/2017). In addition to this, each financial centre has a certain number of functional specialisations which determine the particular sub-sectors which they are targeting for relocation. As another respondent from a global institution based in Frankfurt noted, ‘we see specialisations emerging, where currently Luxembourg and Dublin are qualifying for “specialised” industries, Amsterdam more for the technology side, and now it’s a question of where the classical banking business goes: Paris or Frankfurt?’ (German Market Infrastructure provider, 09/11/2017).

The promotional strategies adopted by Paris and Frankfurt in the aftermath of the Brexit vote also reflect the constitutional context and political systems of which they are part. The French state is organised around a powerful centralised executive. A discernible sovereigntist logic has therefore underpinned efforts of the central government and the office of the President to boost Paris after Brexit, with a number of stakeholders commenting that this effort was being driven from the very top of the French government. Shortly after the Brexit vote, then Prime Minister Manuel Valls declared that he wanted to see Paris become ‘Europe’s premiere financial centre’ and joined lobby organisation Paris EUROPLACE at conferences designed to promote Paris. The government introduced tax and regulatory reforms including lowering corporation tax and extending a tax break for those coming to work in France. As several interviewees confirmed, the election of Emmanuel Macron as President in May 2017 has only served to accelerate the

initiatives begun under the Socialist administration (French financial lobbyist, 26/02/2018; French Treasury official (B), 27/02/2018).

This is in stark contrast to Frankfurt, where the leading role in promoting the financial location has been taken by the Hesse state government and the city-region. With the exception of the application for the location of the EBA, there has been very minimal involvement by the Federal government in Berlin in the promotion of Frankfurt as a financial centre (FMF representative, 10/11/2017). As one Frankfurt stakeholder commented, promoters for the city ‘would have appreciated more involvement [from the Federal government] in this process’ but quickly found that ‘the view from Berlin is that “Frankfurt is a case for the state of Hesse, not the Federal state”’ (Hesse region trade association official, 08/11/2017). In sum, Frankfurt and Paris have distinct characteristics as financial centres - in terms of their existing relations with global banks, their sectoral specialisations and their varying constitutional systems - which shape the emerging competition between them after Brexit.

3. Territorial factors shape the emerging competition between Frankfurt and Paris

A third key observation is that the *territorial* dimensions of financial centres matter. By ‘territorial dimensions’ we mean the specific institutions and frameworks which are ‘embedded’ within both Frankfurt and Paris and which give rise, in turn, to a broader financial ecosystem within each territory. First, territorial considerations play an important role in the business models of various private financial institutions. This is particularly clear in the case of Frankfurt, which plays host to prominent regional and cooperative banks which are deeply integrated into the regional economy of Hesse. The Landesbank Helaba, for instance, is a regional financial institution whose business model consists in lending to local businesses and

households. As a result, its interests are closely tied with those of the region it is located in (Regional bank official in Frankfurt, 08/11/2017). This is manifest in the very prominent role that the bank has played in promoting Frankfurt as a financial location and in participating in the various local marketing initiatives (FMF, 2017: 41). For regional banks such as Helaba, Brexit appears primarily as an opportunity, because the risks of financial instability are offset by the business advantages of increased market activity, jobs and housing prices.

Second, the location of EU regulators and agencies within financial centres shapes the emerging competition between Frankfurt and Paris in important ways. For example, Frankfurt plays host to the ECB and EIOPA, respectively one of the key centres of Eurozone financial supervision and the agency responsible for supervising pension products in the EU. Similarly, Paris plays host to ESMA, which has responsibility for ensuring supervisory convergence in relation to European capital markets and looks set to secure further powers as a result of the Commission's 'European Supervisory Authorities' review. Furthermore, the EBA moved to Paris in November 2017 as a result of its relocation from London after Brexit.

The location of these EU agencies in Frankfurt and Paris is important in shaping the emerging competition between these financial centres. EU regulators insist, of course, that the location of regulatory agencies within a particular financial centre is not designed to - and should not in practice - benefit the host centre. But there are important unintended consequences of these locational decisions which can spill over into a comparative advantage for the 'host' centres. Enjoying 'proximity' to regulators is a key consideration for financial market actors. As one representative of a global bank in Frankfurt put it to us, 'when you have an organisation like the ECB based here, proximity does play a role [...] It attracts critical mass, it has a knock on effect' (Global bank B in Frankfurt official, 10/11/2017). The location of important EU agencies in Frankfurt and Paris helps to underpin a broader 'eco-system' of financial interests which together can prove attractive to firms seeking to relocate after Brexit.

The advantages of ‘hosting’ large EU financial authorities forms a core element in the post-Brexit strategy of both Frankfurt and Paris. As a representative of a leading regional marketing agency in Frankfurt put it to us, ‘[our] key advantage is that it is a financial centre that... already provides the whole ‘ecosystem’ that is required by banks’ (FRM Senior representative, 09/11/2017). Similarly, political actors in Paris are seeking to take advantage of the recent decision to move the EBA to the French capital. One Treasury official noted the key ‘symbolic value’ of the decision, as it demonstrates the ability of the French authorities to facilitate the transfer of banking functions to their territory (French Treasury official (A), 27/02/2018).

4. ‘Regulatory Stability’ is an important asset for competing financial centres

Brexit introduces new forms of uncertainty into the European financial market. Numerous respondents from private financial firms underlined the importance of securing stability in the post-Brexit environment. As the representative of a large US bank in Frankfurt told us, ‘When you’re going through a process of political instability – which is what Brexit injects into the equation – there’s a natural tendency to not look for the next “cool deal”. You’re looking for stability and clarity – a paradigm with which I can work and understand and feel comfortable’ (Global bank B in Frankfurt official, 10/11/2017). Similarly, in Paris, financial operators emphasised the key importance of securing regulatory stability and avoiding regulatory fragmentation after Brexit (French trade association official, 28/02/2018; Global bank B official in Paris, 02/03/2018; French Market Infrastructure provider, 27/02/2018). The ability of financial centres to provide a ‘stable’ regulatory environment has therefore become a key factor in the emerging competition between Frankfurt and Paris. This concern with regulatory stability shapes the race between European financial centres in two related ways.

First, political actors within Frankfurt and Paris are responding to this desire for ‘stability’ in their promotional strategies. One Frankfurt lobbyist stated, ‘Germany is an anchor of stability in a world that is becoming very “interesting” in political and economic terms. Within Germany - in that anchor of stability - you have Frankfurt as a financial centre’ (FRM Senior representative, 09/11/2017). A representative from a global bank in Paris similarly argued that France’s reputation for ‘strong but stable’ regulation ‘is probably something that can attract financial players’ to Paris, particularly larger institutions (Global bank B official in Paris, 02/03/2018).

The second axis through which the question of ‘regulatory stability’ is shaping the competition between European financial centres is in relation to the question of regulatory arbitrage. After Brexit, banks and other financial institutions will have to relocate sections of their businesses to remaining EU member states. This creates the prospect of ‘regulatory arbitrage’, a situation where national regulators, in concert with politicians, loosely apply EU supervisory standards in order to induce investment. Certain smaller financial centres - most notably Luxembourg and Dublin - are regularly identified as centres which may engage in strategies of this nature. As one national regulator in Paris commented, ‘our worry is how small and medium-sized countries could have lower requirements’ and thus engage in a regulatory ‘race to the bottom’ to attract businesses away from more established centres of Frankfurt and Paris. Similarly, a representative of a Frankfurt based banking association commented:

‘At the beginning [after Brexit], there was a competition between the different financial centres but also some regulators...When I spoke to my members, they visited Dublin, Madrid, Paris, Amsterdam, Frankfurt and they said it was quite different what the various authorities told them.... The big fear was that there would be regulatory

arbitrage between the different financial centres. ' (Official from a foreign bank association in Germany, 06/11/2017)

In response, numerous interviewees - in particular from Paris - cited the importance of strengthening the power of EU supervisors such as ESMA. One French Treasury official told us that 'we want to create level playing field...our worry is how small and medium-sized countries could have lower requirements' (French Treasury official (A), 27/02/2018). Far from producing a regulatory 'race to the bottom', our research suggests that powerful actors within alternative European financial centres are utilising Brexit to toughen up regulatory standards through advocating a further transfer of supervisory powers to the EU level.

Implications for future research in EU studies

Our empirical analysis of Frankfurt and Paris after Brexit has important theoretical implications for the EU studies literature more broadly. First, adopting a 'financial centres' perspective, drawing on a well-established literature within economic geography, can improve our understanding of the emerging 'battle' over financial services in Europe. Second, our analysis has important implications for a growing body of literature on European *disintegration*.

European financial centres

Since the breakdown of the Bretton Woods order, the financial sector has expanded rapidly across the global economy (Panitch and Gindin, 2014). The rise of global finance led to a rapid expansion of international financial centres. New York, London and Tokyo emerged as key centres in the new global economy, while 'second tier' centres - such as Frankfurt, Paris and Dublin - also expanded on the back of a rising tide of financial globalisation. However, the EU studies literature has not interrogated the rise of international financial centres or the

implications which this has for European integration (Howarth and Quaglia, 2018). This limits the ability of the EU studies literature, in its current form, to analyse the emerging competition between European financial centres after Brexit.

In order to overcome this blindspot, the EU studies literature would benefit from drawing on literatures from outside the 'integration theory' canon. In particular, there is a well-established literature within economic geography which has theorised the rise of global financial centres (see Taylor, 2001; Sassen, 2011; Wojick, 2013; Hall 2018). John Friedmann and Saskia Sassen originated this research programme, highlighting how global cities at the 'core' of the world economy benefited from and in turn shaped financial globalisation (Friedmann, 1986; Sassen, 2011). This approach was further developed by the so-called 'Globalisation and World Cities' (GaWC) research network, associated with Peter Taylor and his collaborators, which traced the ways in which new patterns of connectivity between international financial centres was conditioning the global economy (Taylor, 2001). The core insight of this approach is that financial centres are peculiar spaces within the contemporary geography of global capitalism. On the one hand, they display a highly *internationalised* character, insofar as they play host to transnational corporations highly integrated into global capital flows. On the other hand, financial centres are always embedded within particular *national* regulatory systems and *local* institutional contexts (Hall, 2017). Financial centres are therefore inherently *hybrid* constellations where global, national and local dynamics interact. Our empirical analysis of Frankfurt and Paris demonstrates how a 'financial centres' perspective, drawing upon this economic geography literature, can illuminate new dimensions of the 'battle' for financial services after Brexit.

First, the strategic orientations of actors within financial centres cannot simply be reduced to a 'battle' between inherently 'transnational' economic and 'national' political interests. In the case of Frankfurt, for example, the Landesbank Helaba has a distinctive business model which

is deeply integrated into the regional economy of Hesse. As a result, Helaba has adopted a proactive approach in boosting Frankfurt as a financial centre. In contrast, a representative of an association representing foreign banks in Frankfurt stated, in relation to the future of the euro-clearing business, that ‘the industry side is not really interested in moving euro-clearing [from the City of London] to another place. We want to avoid fragmentation. From the viewpoint of cost efficiency, it is preferable that all the infrastructure and liquidity is in one place’ (Official from a banking association in Germany, 06/11/2017). Both of these organisations are ‘economic’ in character, yet each has distinct interests in relation to the dynamics unleashed by Brexit. In order to account for these differences, it is necessary to remain attentive to the ways in which their business models are integrated into and shaped by their geographical context.

Second, a ‘financial centres’ perspective illuminates the ways in which the location of EU agencies and national regulators shapes competition between rival European financial centres. The location of European agencies such as the ECB in Frankfurt or the EBA in Paris enhances the attractiveness of these financial centres, insofar as this helps to deepen the ‘ecosystem’ of each financial centre and affords actors within them close proximity to regulatory bodies. Political actors within both financial centres have sought to ‘boost’ their respective territories by consistently highlighting this point. Furthermore, a financial centre perspective can help to make sense of the seemingly paradoxical behaviour displayed by NCAs since Brexit. NCAs - specifically the Bundesbank in the case of Frankfurt and the AMF in the case of Paris - have proactively taken part in ‘roadshows’ and other promotional activities on behalf of their host financial centres. The official rationale for this activity is that the regulators want to ensure that prospective investors are aware of the processes involved in applying for banking licences and other legal issues involved in relocation after Brexit. However, alternative logics are also at play (French trade association official, 28/02/2018). In the French case, the resources at the disposal of the NCAs are partly determined by the level of activity taking place within their jurisdiction. There is therefore a clear institutional logic which can lead NCAs towards ‘boosting’ the size of

business activity within their host financial centre. The territorial ‘embeddedness’ of both EU agencies and national regulators therefore plays a key role in shaping the emerging competition between European financial centres after Brexit.

European disintegration theory

A recent body of literature has attempted to chart emerging patterns of *disintegration* within the EU (Zielonka, 2014; Webber, 2013; Rosamond, 2016; Jones, 2018). This literature seeks to account for how contemporary challenges to European integration, such as rising Euroscepticism, the Eurozone crisis, the migration crisis and Brexit, might be theorised and examined empirically (Bulmer and Joseph, 2016; Hooghe and Marks, 2009). The disintegration literature begins from the premise that conventional approaches in EU studies lack an appropriate toolkit to interrogate emergent disintegrative pressures (Webber, 2014; Jones, 2018). As Rosamond has argued, both supra-nationalist and inter-governmentalist approaches assume that integration takes place against a series of ‘prior background conditions’, including growing ‘economic interdependence’ and ‘transnational exchange’ (Rosamond, 2016; see Moravcsik, 1993; Sweet and Sandholtz, 1997). However, since the global financial crisis, this assumption looks increasingly untenable. The Eurozone crisis, for example, precipitated a rapid fragmentation of European financial markets, as capital fled the Southern European periphery into safer assets in Germany (Offe, 2014). Brexit, similarly, embodies a moment of regulatory decoupling which is likely to increase barriers to trade between the UK and the EU27. Disintegration theorists seek to integrate these disintegrative tendencies into a wider theoretical framework (Webber, 2013; Volland, 2014; Jones, 2018).

There is not sufficient space to fully engage with the growing ‘disintegration’ literature here. However, we can identify two ways in which our analysis builds-upon this emerging theoretical

corpus. First, it is important to note that ‘disintegration’ is not one homogenous process (Jones, 2018: 450). Distinct disintegrative dynamics exist within the social, political and economic spheres (Eppler et al. 2016). In relation to Brexit, it is important to distinguish between the economic *fragmentation* which is likely to follow the UK’s exit from the EU and the institutional response to this dynamic from within the EU institutions. This distinction is particularly important in the sphere of finance. Once the UK becomes a ‘third country’, new barriers to trade between the City and the EU will emerge. In turn, this is likely to generate a geographical fragmentation of business activities across the EU, as firms relocate personnel and functions to different European financial centres within the Single Market.

This dynamic is likely to generate increased transaction costs for financial institutions operating within the Single Market. But this process of financial market *fragmentation* is not synonymous with European *disintegration*. The emerging competition between European financial centres after Brexit increases the threat of regulatory arbitrage, where national supervisors and politicians laxly apply supervisory standards in order to induce investment. For instance, the Irish financial services minister complained in 2017 to the Commission over what he considered to be Luxembourg’s attempt to engage in ‘regulatory arbitrage’ in its attempt to secure investment from the insurer AIG (Boland et al., 2017). As we have seen, the threat of arbitrage was regularly alluded to by our interviewees in Frankfurt and Paris.

One official from the French Treasury suggested that ‘an obvious way to avoid this would be to provide direct supervisory powers’ to European agencies in order to maintain ‘a level playing field’ (French Treasury official (A), 27/02/2018). This comment relates to the recent proposal from the European Commission to enhance the power, resources and mandate of the ‘European Supervisory Authorities’ (ESAs). These include the ESMA, EIOPA and the EBA. The comments from this French Treasury official reflect a broader approach which was evident across our interviews, which was the acknowledgement that enhanced European supervisory

powers would help to constrain ‘unfair competition’ between rival financial centres after Brexit. A French financial regulator, for instance, suggested that the regulator was ‘very much in favour of a stronger ESMA’ in light of the UK’s exit from the EU (French financial regulator, 26/02/2018). One representative of the German banking industry also noted the key role which the ECB, EBA and ESMA would play in preventing the establishment of ‘letter box’ entities within member states (Official from a foreign bank association in Germany, 06/11/2017).

The financial fragmentation associated with Brexit does not therefore deliver a straightforward regulatory ‘race to the bottom’ or indeed a ‘disintegration’ of the EU’s supervisory architecture.ⁱⁱⁱ Rather, as actors respond to Brexit’s fragmentary dynamics and seek to both contain financial instability and protect their relative comparative advantage in financial services, important pressures towards further integration at the European level are being generated. Our analysis of Frankfurt and Paris therefore advances a concrete case study of how fragmentary dynamics and integrative pressures can interact, complementing disintegration theory’s expectation that novel patterns of European development will emerge in the future (Zielonka, 2014: 106; Rosamond, 2016: 868; Jones, 2018: 450).

A second implication our analysis has for disintegration theory relates to the importance of *sub-national* agency in shaping disintegrative dynamics. Disintegration theorists have pointed to numerous drivers of disintegration, including shifting patterns of international power (Webber, 2014), deficiencies in the structuring of the EU as a political community (Vollaard 2014), and the fracturing of the ‘democratic capitalist compact’ in Europe (Rosamond, 2016). These approaches all point to how macro-level reconfigurations contribute to disintegrative tendencies in the EU. Our focus on financial centres adds a further dimension to these analyses, insofar as it highlights how *sub-national* actors shape disintegrative pressures in Europe. ‘Rival’ European financial centres to the City of London, taken broadly, are set to benefit from financial market fragmentation. Across our interviews, numerous respondents acknowledged the key opportunity

which Brexit presented to them. One interviewee from Frankfurt stated that, '[After Brexit] a tagline for us was: "never waste a good crisis". Brexit is bad for Europe, bad for the UK, bad for Germany, but it's a once in a century chance for Frankfurt' (FMF representative, 10/11/2017). As we have seen, political actors and marketing agencies within both Frankfurt and Paris have mobilised, often with the tacit support of their respective NCAs, in order to 'capitalise' on the Brexit process. In each case, the distinctive legal, political and regulatory architecture of each financial centre is utilised to boost post-Brexit investment.

Conclusion

Brexit involves a 'regulatory decoupling' of the UK from the EU. This has potentially far-reaching consequences in the sphere of EU finance. Brexit is likely to generate a fragmentation in EU financial integration which in turn imposes clear costs on member states. But it also creates the opportunity for alternative European financial centres to 'capitalise' on Brexit. Tracing the emerging competition between European financial centres should therefore form a key area of future enquiry. However, as we have argued, EU studies is ill-equipped at present to interrogate this emerging process. Conceptually, conventional approaches to EU finance tend to privilege either the supra-national or inter-governmental scales of analysis. This renders the sub-national scale of financial centres relatively invisible in the literature. In this article, we have sought to fill this lacuna by advancing an empirical and comparative account of Frankfurt and Paris as two leading financial centres in the aftermath of the Brexit vote.

Our analysis opens up new avenues for research in EU studies. Empirically, we have argued that the issues of *diversity*, *path dependency*, *territory* and *regulatory stability* shapes the emerging competition between Frankfurt and Paris in important ways. European financial centres contain numerous actors with distinct strategies and preferences. Future research should trace the evolution of the strategies of these actors as the Brexit process unfolds. More broadly, future analysis should interrogate the ways in which the tension-ridden politics of financial centres

feeds into national models of capitalism and may have an impact on non-financial firms who are reliant upon capital market funding from the City and other European financial centres.

Financial fragmentation after Brexit also threatens to diminish the global competitiveness of European financial markets. In this situation, the true ‘winners’ from the UK's exit may lie outside the EU, as financial activity is re-located to the US and to emerging East Asian markets.

Since the Eurozone crisis, new theories of *disintegration* have emerged alongside more conventional integration theories. Our empirical material suggests that disintegrative tendencies and functionalist integrative pressures are not mutually exclusive. They coexist and combine in important ways. Brexit both threatens financial market fragmentation *and* acts as a driver of new integrative dynamics, for example in relation to supervisory convergence at the EU level. Again, our sub-national perspective on financial centres underlines the point that these divergent pressures do not operate ‘behind the backs’ of financial centre actors. They must be interpreted and acted upon, both by ‘political’ and ‘economic’ actors. This in turn opens up future pathways of research in relation to financial centres. Specifically, it suggests that future research should trace how the divergent interests of actors within European financial centres are managed politically and how, in turn, this process shapes national models of capitalism, European finance and the European integration process more broadly.

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Notes

- (1) At the time of writing (September 2018), Theresa May was attempting to secure her government's 'Chequers Deal' at the EU level. This would involve alignment on goods but not on services. This proposal was poorly received by the EU authorities and faced trenchant parliamentary opposition in the British parliament. If a variant of Chequers fails, the prospect of a 'No Deal' scenario is one possible outcome. Alternatively, a general election or even a second referendum may be held to resolve the deadlock.
- (2) Other European financial centres of course may benefit from Brexit as well. Dublin, Luxembourg, Milan, Amsterdam and Zurich are regularly cited as possible candidates. We focus on Frankfurt and Paris due to the combination of the size of their financial centres and their political significance (Cassis, 2018: 14). Future comparative research should interrogate the relation between Brexit and other smaller European financial centres.
- (3) There is no guarantee, of course, that Brexit will inevitably lead to supervisory convergence in the sphere of finance. Although the Commission has pushed for greater powers for the ESAs, some domestic actors – notably some NCAs and sub-sections of finance – are likely to oppose further convergence at the EU level. Future research should trace the emerging politics of post-Brexit financial supervision.

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